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Flaux-ting the Rules: Punitive Damages in English Law

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English law is slow to award punitive or exemplary damages. They are rarely seen in commercial disputes where the measure of damages tends to be compensatory. Nonetheless, as a matter of legal principle, punitive damages are available for all torts that involve a wilful element on the part of the tortfeasor. Punitive damages have been awarded for defamation, trespass to land or the person (including assault) or false imprisonment, but they are also available for torts involving dishonesty, such as deceit. Victims of commercial fraud could therefore be able to claim more than the loss they have suffered, provided that the requirements for an award of punitive damages are satisfied.

In *Axa Insurance UK Plc v Financial Claims Solutions Ltd* [2018] EWCA Civ 1330, the Court of Appeal overturned the High Court and recently awarded punitive damages for an insurance fraud, where the insurer had detected the fraud before making any payments. This article considers to what extent the Court of Appeal's decision clarified the law or expanded the scope for punitive damages. The crucial question is precisely what needs to be shown to elevate the tortfeasor's conduct from a 'run of the mill' fraud to something more, that warrants a punitive award.

A Brief History of Punitive Damages in English Law

Any discussion of the modern principles relating to punitive damages starts with *Rookes v Barnard* [1964] UKHL. In that case, the House of Lords narrowed down the circumstances in which such damages can be awarded. As McGregor on Damages put it, the *"situation totally changed"* as a result of *Rookes v Barnard (*19th Ed, 13-03). Prior to 1964, awards of punitive damages had increasingly featured in the English legal landscape since making their first appearances in the 1760s. It should, however, be noted that even in the relative heydays of punitive damages, they were never available for breach of contract, no matter how egregious or deliberate the breach. That limitation was affirmed in *Addis v Gramophone Co. Ltd* [1909] AC 488 and has not been eroded since.

Until *Rookes v Barnard*, the House of Lords itself had never had the opportunity to consider the rationale for punitive damages. That led their Lordships to ask whether, in the absence of binding precedent, they could *"… remove an anomaly from the law of England."* They did not go quite go that far, instead noting the exceptional nature of punitive damages in the civil law of damages (primarily concerned with compensation and not punishment), confining them to a few exceptional circumstances. Those circumstances are set out in the speech of Lord Devlin, described by the High Court in *Axa* as the *"fount of the modern jurisdiction to award exemplary damages"*. Lord Devlin established two categories of cases as surviving the cull. The first category relates to misconduct by public official. The second category, much more likely to be relevant in commercial disputes, was described as follows:

> *"Cases in the second category are those in which the defendant's conduct has been calculated by him to make a profit for himself which may well exceed the compensation payable to the plaintiff … Where a defendant with a cynical disregard for a plaintiff's rights has calculated that the money to be made out of his wrongdoing will probably exceed the damages at risk, it is necessary for the law to show that it cannot be broken with impunity.*

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> *This category is not confined to moneymaking in the strict sense. It extends to cases in which the defendant is seeking to gain at the expense of the plaintiff some object—perhaps some property which he covets—which either he could not obtain at all or not obtain except at a price greater than he wants to put down. Exemplary damages can properly be awarded whenever it is necessary to teach a wrongdoer that tort does not pay."*

The debate about whether punitive damages had any place in English law has continued since Lord Devlin's pronouncement. In 1997, the Law Commission published a report concluding that, in their view, the power to award such damages should continue to be part of English law.

In 2001, the House of Lords again considered the matter, in *Kuddus v Chief Constable of Leicestershire Constabulary* [2001] UKHL 29. A police officer had simply forged the victim's signature on a form consenting to the abandonment of a police investigation into the crime in question. The Chief Constable, sued vicariously for the officer's action, argued that exemplary damages had never before been awarded for this particular type of misfeasance in public office, and sought to have the claim struck out.

Their Lordships decided that punitive damages were not confined to just certain causes of action in tort. Their justification lay in the outrageousness of the defendant's conduct. As Lord Slynn put it, there was nothing in Lord Devlin's statements to suggest that, in addition to the particular requirements (for the second category, cynical disregard of the claimant's right and a calculation that the profit may exceed the compensation payable), one also had to consider the law reports going back to the 1760s to check whether punitive damages had previously been awarded for the particular cause of action. It was the defendant's behaviour that had to be looked at. As Lord Nicholls put it:

> *"From time to time cases do arise where awards of compensatory damages are perceived as inadequate to achieve a just result between the parties. The nature of the defendant's conduct calls for a further response from the courts. On occasion conscious wrongdoing by a defendant is so outrageous, his disregard of the plaintiff's rights so contumelious, that something more is needed to show that the law will not tolerate such behaviour. Without an award of exemplary damages, justice will not have been done. Exemplary damages, as a remedy of last resort, fill what otherwise would be a regrettable lacuna."*

The Fraudulent Scheme in *Axa*

Turning to the dishonest scheme that led to the litigation in *Axa v Financial Claims Solutions*, the defendants had sought to defraud Axa by obtaining default judgments and then seeking to enforce those against Axa in respect of fictitious road traffic accidents allegedly caused by motorists insured by Axa. These claims had been pursued by an entity purporting to be authorised to conduct litigation when it was not, which was controlled by the fraudsters. The fraudsters had manufactured medical evidence suggesting whiplash injuries and hire purchase agreements said to show the cost of replacement cars. They obtained default judgments against the insured, for more than £85,000 in total. Having obtained default judgment against the alleged Axa policyholders, the fraudsters then commenced proceedings against Axa under the Road Traffic Act 1988 seeking to enforce the default judgments against the insurer. To prove service on Axa, they sent envelopes full of junk mail by registered post. Unsurprisingly, Axa's mail room disposed of them. The fraudsters persisted in conducting the litigation as if they were solicitors (a criminal offence) and making misrepresentations to the court, including a certificate of service on Axa which led to a default judgment against the insurer. They also obtained writs of enforcement. Bailiffs attended Axa's offices intent on seizing computers to satisfy the apparent judgment debt. At that point, the scheme began to unravel. Axa's solicitors obtained an urgent stay of execution and a transfer

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of the proceedings to the High Court. They then uncovered the extent of the deception. Soon enough, the claims against Axa were struck out and, following third party (Part 20) proceedings by Axa, judgment was entered against the fraudsters for deceit and unlawful means conspiracy. Separately, the main perpetrators of the fraud were also convicted of criminal offences.

No Punitive Damages for *Axa* in the High Court

In Axa's tort claim, the High Court awarded Axa the costs it had incurred (both internal and external) in investigating the fraud, of just under £25,000, as compensatory damages. The learned judge did not, however, award punitive damages that had also been claimed. Axa had relied on Lord Devlin's famous dictum in *Rookes v Barnard*, submitting that the second category *("… the defendant's conduct has been calculated by him to make a profit for himself which may well exceed the compensation payable to the plaintiff …")* was directly applicable to the fraud that had been attempted against it. The fraudsters had tried to extract as much as £85,000 from Axa, when the costs of putting the matter right came to about a third of that. It was put to the learned judge that such conduct was quite deliberate, difficult to detect and potentially highly profitable, such that punitive damages were justified.

The High Court disagreed. The judge emphasised the limited scope and exceptional nature of punitive damages. He thought that a punitive award could only be justified where compensatory damages were insufficient to remove the tortfeasor's unlawful gain. Among the examples given in the judgment of cases that would merit a punitive award was that of a newspaper which knowingly and deliberately published a defamatory story, thinking that the profit to be made from the paper's increased circulation would outweigh any damages for libel that might be awarded against it. In the High Court's view:

> *"... Lord Devlin was not talking merely about conduct that simply is so malign or anti-social that it seems to call for punishment. That description could apply to many cases that do not usually attract exemplary damages; for example, all cases of fraud might be so described. Nor does his dictum justify awarding exemplary damages just because a defendant has committed a tort in the hope of getting away with it; probably most fraudsters do that, many of them successfully. Exemplary damages are not a substitute for the criminal law. They are (at least so far as the second category is concerned) available for the case where compensatory damages are inadequate to remove the wrongful gain achieved by the tort where paying compensation in accordance with normal principle would leave the tortfeasor "up on the deal"."*

However, the insurance fraudsters were not 'up on the deal' – nor could they ever be. They had tried to scam Axa out of money. The profit and the compensation would always be identical because damages for deceit would amount to any money that had been extracted. The judge felt that Axa's case amounted to saying that punitive damages should be awarded because the loss caused by the fraud, if the fraud had succeeded, would have been greater than compensatory damages that could be awarded when the fraud had actually been discovered. To accept that proposition would be, the judge thought, to extend the scope of punitive damages too far. He did not accept that punitive damages could be used as a vehicle for social policy, when Axa or other insurers that fell victim to these kinds of schemes had avenues open to them through the criminal courts. This particular case did not *"fall remotely within Lord Devlin's second category"*. To suggest otherwise would, the judge thought, be a fundamental misunderstanding of the law.

The Court of Appeal has no Difficulty in Allowing Axa's Appeal

Undeterred by the judge's criticism, Axa appealed. One of the few things that the Court of Appeal and the judge below appear to have agreed on was the proposition that punitive damages were an exception and ought not to

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be extended. Even so, Flaux LJ, giving the judgment of the court, had no difficulty in allowing the appeal. The object of the fraud had been to extract as much money as possible from the insurer. He considered it relevant that if the fraud failed, then compensation would be much less than the potential profit (the point which the judge had roundly rejected), so punitive damages ought to be available. Flaux J held that:

> *"The judge's analysis that the profit and the compensation would be identical looks at the matter through the wrong end of the telescope and overlooks that the second category requires the Court to analyse the position prospectively when the tort is committed, at which time the tortfeasor may or may not ultimately achieve the profit it seeks to achieve. Hence Lord Hailsham's references to "the chances of economic advantage" outweighing "the chances of economic penalty", reflecting what Lord Devlin had said about the wrongdoer calculating that the profit "will probably exceed the damages at risk". In any event, as Sharp LJ pointed out during the course of argument, if the fraud had been successful, Axa would have paid the claims and the monies would have disappeared, so that even if the fraud had been subsequently uncovered, the compensation Axa would be likely to have recovered would be nothing like the profit the wrongdoers had achieved."*

The Court of Appeal concluded that this was a paradigm case for awarding punitive damages. The defendant's conduct had been very serious, and warranted an award that would deter others from pursuing similar 'cash for crash' frauds, which the Court of Appeal felt had already increased insurance premiums. As for the criminal proceedings against the fraudsters, Flaux LJ felt that this did not affect the power to make a punitive award. The Court of Appeal awarded £20,000 in such damages against each of the defendants.

Did the Court of Appeal Expand the Scope for Punitive Damages?

The Court of Appeal's decision is robust, but does it expand the scope of punitive damages by perhaps not strictly applying some of the requirements that Lord Devlin set out for the second category of cases?

There are two points that merit closer consideration. The first is the requirement that, for any award of punitive damages under the second category, the defendant's conduct must have been *"… calculated by him to make a profit for himself which may well exceed the compensation payable …"*. What exactly is meant by that calculation? The second is the key matter on which the Court of Appeal and the judge differed: the tortfeasor had not in fact made a profit, and was thus punished for his conduct alone. Does this fit with the earlier authorities, or must the tortfeasor have made a profit?

What is Meant by 'Calculated Conduct'?

Flaux LJ's statement of principle was as follows (at 30):

> "[Citing Rix LJ in *Borders (UK) Ltd v Commissioner of Police of the Metropolis* [2005] EWCA Civ 197]:
>
> *"… controversial as [punitive damages] are, they are not to be contained in a form of straight-jacket, but can be awarded, ultimately in the interests of justice, to punish and deter outrageous conduct on the part of a defendant. As long therefore as the power to award exemplary damages remains, it is not inappropriate in a case such as this, where the claimants have been persistently and cynically targeted, that they, rather than the state, should be the beneficiaries of the court's judgment that a defendant's outrageous conduct should be marked as it has been here. They are truly victims, and … there is no question at all of the award becoming a mere windfall in their hands."*

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> *"Provided that it is recognised that the criterion which Lord Devlin identified, that the wrongdoer has calculated that the profit to be made from the wrongdoing may well exceed any compensation he has to pay the claimant, must have been satisfied for exemplary damages in the second category to be available, this seems to me to be an appropriate statement of the approach to be adopted to the award of exemplary damages in this category.""*

The first paragraph of Flaux LJ's statement (citing Rix LJ in *Borders*) emphasises the wrongdoing that is being punished – an obvious and understandable justification for awarding punitive damages. The second paragraph stresses the requirement ('Lord Devlin's criterion') of a (prospective) calculation that the profit to be made from the wrongdoing *"may well"* exceed the compensation payable to the victim. As noted earlier, Flaux LJ found that this had to be considered prospectively, when the tort was being committed. However, assuming that what is required is a calculation of the likely net outcome of the fraud, it is not easy to think of a fraud which involves obtaining money or property from the victim that could satisfy the requirement. All that the fraudster stands to gain, the victim stands to recover in a claim for compensatory damages.

Assume that the fraudsters in *Axa* had 'calculated' their chances before embarking on the fraud. They work out their 'economic advantage': that is all the money that they hope Axa will pay them. Presumably they also think that the chances of securing that advantage are good (they are careful fraudsters who would not embark on a scheme they think will see them caught). They then consider the other side of the coin. What are the chances of suffering an 'economic penalty'? If the fraud succeeds but they are caught, they would be liable to repay Axa any money they have been able to extract. That penalty is the same as the economic advantage they are seeking. They are probably also going to be liable for Axa's costs in investigating, uncovering and then 'prosecuting' (in the civil courts) the fraud, reclaiming the money. With those costs added into the mix, it now looks as if the chances of economic penalty outweigh the advantage.

The judge's newspaper example would of course satisfy this requirement – because in that example, the tortfeasor is able to monetise the tort by increasing its own circulation by publishing the defamatory piece. Suppose the wrongdoing is aimed at discovering some business secret or proprietary information, which the tortfeasor can use to boost its own business. That would amount to a breach of confidence, an equitable wrong, for which an account of profits (actually made by the wrongdoer) is available – but not an award of punitive damages.

What about Sharpe LJ's comment in *Axa*, noting that if the fraud had been successful, the money would have disappeared – so *"… that even if the fraud had been subsequently uncovered, the compensation Axa would be likely to have recovered would be nothing like the profit the wrongdoers had achieved."* That amounts to saying that punitive damages should be awarded if the fraud was unsuccessful, because, if the fraud had been successful, the fraudsters would have made off with the money, or would have dissipated it, and been unable to satisfy a compensatory award. Presumably, in that scenario the fraudsters would be equally unable to satisfy a punitive award. Sharpe LJ's comment may be a justification on public policy grounds: because the fraudster was unlikely to be caught and full restoration was unlikely if they had succeeded, they should be punished even though they failed. It does not, however, squarely address Lord Devlin's requirement for a 'calculation' (to be done prospectively).

However, it appears that this calculation does not need to be mathematical, as noted briefly by Flaux LJ (at 18), or a precise balancing process. It is more rough and ready than that. As the House of Lords found in *Broome v Cassell* [1972] AC 1027:

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> *"What is necessary is that the tortious act must be done with guilty knowledge for the motive that the chances of economic advantage outweigh the chances of economic, or perhaps physical, penalty. ...*
>
> *The situation contemplated is where someone faces up to the possibility of having to pay damages for doing something which may be held to have been wrong but where nevertheless he deliberately carries out his plan because he thinks that it will work out satisfactorily for him."*

So the crux of the matter may lie in the fraudster thinking that they will get away with it and that it will be worth it. But which fraudster thinks any different? And what about the fraudster who has such animosity for their chosen victim that their motive is to cause injury regardless of the consequences that they might suffer – their motive in committing the wrong is to cause damage, rather than to make a gain or be better off as a result. Presumably they are also deemed to be sufficiently 'calculating'?

Looked at in this light, this part of Lord Devlin's requirement may not help much when trying to differentiate fraudulent conduct meriting an award of punitive damages from fraudulent conduct for which only 'normal' (compensatory) damages are available. Of course, Lord Devlin also required there to be a cynical disregard of the claimant's rights, or 'outrageous conduct'. Precisely what may satisfy that separate requirement is not easy to distil from the authorities, but the decision in *Borders* (discussed below) suggests that repeatedly (and perhaps successfully) targeting the same victim may warrant a punitive award.

Must the Fraudster Have Made a Profit?

That still leaves the question whether the fraudster must have made a profit or whether conduct alone warrants punitive damages. In his analysis, Flaux LJ thought that Lord Devlin's second category should not be limited to cases where *"… the profit made by the wrongdoer cannot be fully recovered by the victim through an award of compensatory damages"* (at 26). Other authorities also suggested that an award of punitive damages should not be affected by *"… whether the claimant could have claimed the disgorgement of the tortfeasor's profit"* as compensation (at 27). All this, however, presupposes that the tortfeasor is sitting on a profit, which was not the case in *Axa*.

Flaux LJ agreed with Counsel for Axa that it would be wrong to limit exemplary damages to situations when *"the profit made by the wrongdoer cannot be fully recovered by the victim"* through compensatory damages (at 28). That does not go as far as saying that exemplary damages are available where no profit has been made (even though, logically, the victim could not claim compensatory damages). Here, Flaux LJ referred to an earlier decision by the Court of Appeal, *Ramzan v Brookwide Ltd* [2011] EWCA Civ 985. In that case, the claimant could have claimed an account and thus *"stripped [the defendant] of all its remaining profits"* which had been made through the wrongful appropriation of the claimant's property. The claimant failed to bring that claim, but did claim (and was awarded) punitive damages. Arden LJ held that (at 81):

> *"To award exemplary damages by reference to the profits for which a claim could have been made would also set a precedent which might lead to a disproportionate remedy in a case where the profits were much larger."*

This does not deal with the situation where no profits have been made. On the contrary, it suggests that exemplary damages ought not to be linked to such profits as the claimant could recover through an account, because there might be other (greater) profits which the claimant could not so recover – but for which exemplary damages might be awarded.

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In *Kuddus*, the House of Lords made a number of comments which relate to that point. Lord Scott (at 109) described Lord Devlin's second category as relating to cases where the defendant, through his wrongful conduct had made a profit which exceeded the compensation payable to the victim. His Lordship appears to have focused on the ultimate outcome or effect of the conduct (like the judge at first instance did in *Axa*), as opposed to the *likely* result at the time of committing the tort. Lord Scott also suggested that the second category had largely been overtaken by the law of restitution, such that *"… the profit made by a wrongdoer can be extracted from him without the need to rely on the anomaly of liquidated damages."* This further suggests that his Lordship was concerned about taking away a gain that the tortfeasor had actually realised. One could perhaps ask whether that is sufficient punishment, because removing the gain would not leave the tortfeasor worse off than he was before the tort was committed. Lord Nicholls in *Kuddus* (at 67) said that, for his part, he was not entirely persuaded by Lord Devlin's second category, which he said was about *"wrongful conduct expected to yield a benefit in excess of any compensatory award likely to be made".* That is not about disgorging a real profit – because the expected benefit may not materialise. However, Lord Nicholls then immediately went on to say that the law of unjust enrichment had developed at a considerable pace, which was why he wondered whether Lord Devlin's second category was still needed. Unjust enrichment, however, requires that there has been an enrichment, not just conduct expected to lead to enrichment.

Both Lord Scott and Lord Nicholls were speaking *obiter* in *Kuddus*, because the House of Lords only had to decide whether punitive damages could be awarded for misfeasance in public office (and Lord Scott considered himself in a minority position). Some further guidance can be obtained from the decision of the Court of Appeal in *Borders* (cited by Flaux LJ in Axa). That case involved the fraudulent and criminal activities of Mr Jordan, described as a *"literary Fagin"*. Mr Jordan was a street trader. He had sold hundreds of thousands of stolen books from his stalls in Waterloo and the City, making very considerable profits. When he was charged with unlicensed trading, a total of 46,780 books were seized. When Mr Jordan was arrested, his bank balance was a very healthy £600,000. He was duly arrested, convicted of (criminal) conspiracy and sentenced to almost three years imprisonment. As part of the criminal proceedings, his remaining assets were also being made the subject of a confiscation order.

He then faced a civil, tortious claim for damages, which came before the Court of Appeal. A consortium of booksellers had started to mark books of the kind that Mr Jordan specialised in selling. As the books seized from Mr Jordan had their marks, the booksellers could prove that they were the victims of the fraud. Compensatory damages were assessed by taking the retail value of the books when they were stolen and deducting from it the resale value when recovered. That came to about £230,000. To this were added the costs of marking and tracing the books, a further £46,000. The booksellers were also able to persuade the High Court that they were still out of pocket, because Mr Jordan was likely to have sold many thousands of books, also stolen from them, which were never recovered. They were awarded an additional £100,000 in punitive damages. The Court of Appeal upheld this award. It did not matter that the booksellers could have claimed additional damages on a compensatory basis, by proving their greater losses. Neither was there any real danger that Mr Jordan might end up having to pay the same £100,000 twice, bearing in mind the criminal confiscation proceedings.

Rix LJ felt that the case came within Lord Devlin's second category. Mr Jordan knew from his own long-standing criminal experience that his conduct was profitable and that the law was not readily able to stop him. He took a gamble that the rate at which his criminal enterprise generated profits were worth the future risk of having to pay compensation. That was sufficient to satisfy Lord Devlin's requirement for a 'calculation' (as discussed above). It seems that Rix LJ also took note of the fact that Mr Jordan's criminal enterprise had been ongoing, and profitable, for some time: Mr Jordan had been acting with *"cynical persistence, preferring his own profit to any regard for his victim's losses."* He also noted that the claimants had been *"persistently targeted"*. These

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comments could also suggest that Mr Jordan having actually made a profit over a prolonged period of time justified the award of punitive damages.

Sedley LJ took a similar view. He thought that the modern 'enhanced' compensatory system of damages could accommodate a punitive element (though that was an anomaly), commenting that (at 26):

> *"When one recalls that the rationale of the second category of exemplary damages is, precisely, the confiscation of profits which cannot be got at through the ordinary compensatory mechanisms, this is an attractive synthesis. Exemplary damages fill a moral gap, and it has always been the principal moral objection to them that by handing the penal sum to whoever happens to be the claimant the law hands them a windfall."*

None of this expressly supports the Court of Appeal's decision in *Axa*, that punitive damages for deceit and unlawful means conspiracy could be awarded where the defendant had made no profit, and where it seems difficult to say that the victim had been cynically or persistently targeted.

Conclusion

It is tempting to describe *Axa v Financial Claims Solutions* as a policy-driven decision dealing with a legal principle that has frequently been described as controversial. The Court of Appeal's decision does seem to go further than previous case law, focusing solely on the defendant's conduct and seemingly placing no emphasis on any wrongful gains realised through the unlawful enterprise. As matters stand, anyone who has been the victim of dishonest conduct could seek to claim punitive damages, provided the conduct is sufficiently outrageous. Of course, awards of punitive damages will be proportionate and principled, and tend to be modest, usually around £15,000 to £20,000. The sums awarded may, however, reflect the sums at stake in the relevant cases (which include a number of County Court matters relating to insurance frauds). It remains to be seen how the courts or arbitral tribunals would react to a much larger claim for punitive damages advanced on the basis of Axa following a major (attempted?) fraud in the corporate, financial or projects sector.

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